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C O N F I D E N T I A L CARACAS 000363

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USCINCSO FOR POLAD

E.O. 12958: DECL: 01/30/2014
TAGS: ECON EFIN PGOV VE
SUBJECT: CHAVEZ CONTINUES FIGHT WITH CENTRAL BANK AT A LOWER KEY

REF: (A) CARACAS 103 (B) 03 CARACAS 4011

Classified By: Charge d'Affaires Stephen G. McFarland for reasons 1.4(b) and (d)

Summary

¶1. (C) President Chavez has continued his campaign against the Central Bank of Venezuela (BCV), on January 18 characterizing the Bank's international reserve holdings as "excessive." In a speech January 28, BCV Director Domingo Maza Zavala held firm, saying the reserves were necessary to maintain the strength of the bolivar. The dispute between the administration and the BCV exists against a backdrop of parallel currency market troubles for the bolivar and Ministry of Finance debt-juggling. With the bolivar trading at sometimes twice the official rate on the parallel market, the GOV is likely to issue new foreign debt to add some dollars to the economy. Perhaps in light of that probability, Chavez has dropped his anti-BCV statements to more generic political statements in recent days. End summary.

Excessive...

¶2. (U) In an appearance on the weekly "Alo, Presidente!" program January 18, President Chavez and Minister of Planning Jorge Giordani claimed that Venezuela's current international reserve holdings of USD 21 billion were "excessive." Giordani stated that USD 15 billion was a sufficient level of reserves for an economy the size of Venezuela's. He even claimed to be working on a new "economic theory" that would define exactly what was excessive. Chavez and Giordani ascribed the withholding of reserves by the BCV as a neoliberalism-imposed limitation on Venezuela's development. Despite these claims, Chavez did not explicitly ask the BCV for more than his original demand of USD 1 billion to finance unspecified agricultural programs (Ref A).

Is Subjective

¶3. (C) The BCV has not budged from its position that a raid on reserves is both legally and economically unsustainable. Most recently, BCV Director Domingo Maza Zavala engaged in an "ECON 101 Course" in a speech to an economic forum January ¶28. Maza Zavala said that despite Chavez administration claims the reserve holdings were not excessive, indeed suggesting that the concept of "excessive reserves" did not make sense. He added that the BCV's holdings were necessary to ensure the value of the bolivar. Maza Zavala theorized that in the absence of exchange controls, the BCV's holdings would fall "within a month" to approximately USD 8 billion. (Note: Maza Zavala's statements hold Greenspan-like weight in Venezuela. Despite Chavez's description of the BCV as a haven for neoliberals, Maza Zavala is decidedly leftist in orientation. The octogenarian has worked at the BCV for over forty years and has been a director since 1994. To say that he is personally impervious to political pressure is an understatement. End note.)

Parallel Rate Spikes

¶4. (C) Fueled largely on rumors of an imminent devaluation and Chavez's railing against the BCV, the parallel market exchange rate peaked at approximately 3,200 bolivars/USD, twice the official rate, during the week of January 19. Miguel Santos, Chief Economist for the Venezuelan-American Chamber of Commerce and Industry (VENAMCHAM), told econoff January 22 that Finance Minister Nobrega had broached the subject of devaluation with President Chavez at Miraflores on the night of January 19. According to Santos, Chavez had

rejected the idea as politically impossible with the recall referendum still a possibility. Santos said his opinion was

the GOV would have to devalue relatively shortly in order to utilize exchange rate gains on reserve holdings to finance Chavez's electoral spending plans. Other economists with whom we have spoken, including some associated with the Andean Development Fund, see devaluation well into the future, but agreed that is was eventually inevitable.

MOF Managing Debt

¶5. (C) Alejandro Dopazo, Director of Public Credit for the Ministry of Finance, told econoffs January 27 that the GOV had sufficient resources to keep the bolivar at the 1,600 official rate through 2004. However, he said this was only possible if the GOV adhered to its historical pattern of 75-80 percent budgetary execution. Anything above that amount would require either exchange rate adjustment or additional debt operations according to Dopazo. He also said the Ministry's main task for 2004 was to lower the domestic debt maturities coming due over the next three years. These maturities represent approximately 85 percent of Venezuela's USD 18 billion internal debt load. Dopazo hinted that a significant amount of this refinancing would be in the form of external debt offerings. (Note: Two external debt offerings in 2003 were used as indirect exchange rate management vehicles. See Ref B.)

¶6. (C) Other avenues remain open for additional funds for GOV spending on Chavez's pet projects. BCV Director of International Relations Mary Dager told econoff January 20 that the Bank was sensitive to the economic demands of the country and was seeking legal ways to agricultural lending. Following Dager's comments on January 22, the BCV lowered reserve holding requirements two percent for banks that meet the GOV-mandated agricultural share of their loan portfolios. That figure stands at 12 percent, although few banks meet the requirement. The BCV also has USD 7.5 billion in certificate of deposit holdings in foreign banks. In the past, the GOV has used earnings from these types of deposits to fund spending.

Comment

¶7. (C) In the latest "Alo, Presidente!" on February 1, Chavez kept his rhetoric against the BCV in check. His brief remarks on the reserve issue were restricted to demands that the BCV guarantee agricultural financing and "not only with promises." Professor Gustavo Garcia of the Higher Institute of Business studies told econcouns January 22 that severe inflationary effects on the parallel exchange rate could be felt in as little as one to two months if Chavez were successful in obtaining the unrestricted reserve transfer from the BCV to GOV coffers. We can assume that Fin Min Nobrega has told Chavez the same. In the forum that mimics Chavez's thought-de-jeur most closely, his supporters in the National Assembly have likewise fallen silent on the issue, preferring raucous debate over their own procedures or changes in the Supreme Court Law.

¶8. (C) The current environment perfectly illustrates the cross-pressures in the Venezuelan economy. GOV fiscal health is dependent on low levels of budget execution, but its political health is dependent on short-term electoral spending. Over the past week, Chavez and the BCV have called a truce that probably has two root causes. First, the BCV has hinted all along that some sort of legal accommodation could be found. Second, the MOF could not ignore the parallel rate being twice as much as the official exchange rate and will probably seek another bonds-for-dollars debt issue. That measure requires a kinder, gentler Chavez to soothe investor worries. Whether this is a conscious choice on his part or just another lapse of attention remains to be seen.
MCFARLAND

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